Article | 12 August 2024

Czech Republic

Czech services inflation remains stubborn, paving the way for hawkish CNB

Headline inflation picked up to 2.2% in July, exceeding expectations from both the market and the Czech National Bank. The price dynamic in the services sector remained elevated, which will support the Bank Board's hawkish stance

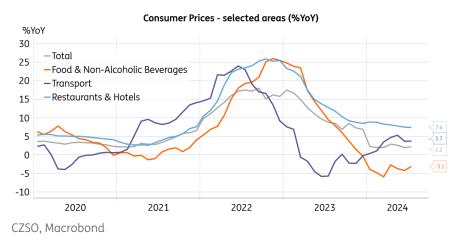


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Robust price growth in the service segment continues

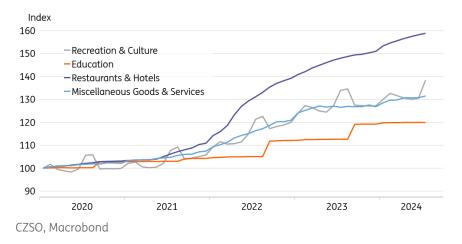
Czech annual inflation increased to 2.2% in July, coming in 0.2 percentage points above the CNB and market expectations. In monthly terms, consumer prices added 0.7% from the previous month, mainly due to higher prices in the recreation and culture section. Prices of food and non-alcoholic beverages gained from the previous month but have remained in decline annually for eight consecutive months.

Czech inflation picked up



The price dynamic throughout the service sector remained stubbornly elevated, with prices in restaurants and hotels maintaining a strong annual growth rate of 7.4% in July. At the same time, prices in recreation and culture, along with other services, accelerated on an annual basis, while posting a monthly increase in July. Prices in the housing section secured the largest overall contribution to annual inflation in July, with rents adding 6.8% from a year earlier. Goods and services for maintenance rose 4.4% year-on-year, and water charges picked up by 10.9% from a year earlier.

Prices of services continue in an upward trend

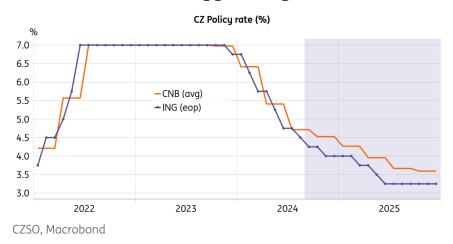


Annual core inflation quickened to 2.3% in July, which was 0.1 percentage points above the CNB's expectations. One of the important drivers of July's consumer prices and core inflation was the seasonal increase in bills for package holidays. However, the pick-up was more pronounced than in previous years, recording a 25.1% month-on-month rise this July. It reflects the rebound in consumers' appetite for spending and the robust growth of real retail sales.

Inflation above target provides grounds for CNB hawkishness

Inflation remaining above the target will lend support to the CNB's hawkish stance, considering the outlook of an elevated policy rate trajectory. That said, there is quite some dissonance between the CNB projection of tight monetary policy at the horizon of at least the next three quarters and the market view, which sees rates below the CNB trajectory. The Bank Board signalled that it has decided to keep monetary policy restrictive to support savings and investment, and this inflation print creates a base for further CNB hawkishness in the coming months.

CNB rates outlook suggests tight conditions



Meanwhile, the Czech economy is not in a robust recovery mode at this point, with recent data suggesting more uncertainty when looking ahead. It is challenging to foresee the overall economic performance when the dichotomy between buoyant consumer spending on the one hand and underperforming manufacturing on the other is so pronounced and persistent. Moreover, households can further draw on their substantial savings, keeping the demand side going, despite firms becoming more reluctant to increase wages in light of the deteriorating economic outlook and mounting uncertainty. Perhaps we could still see ongoing robust spending in the next few quarters despite the tight monetary policy stance, which would provide the CNB with a solid base for insisting on the tightness.

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